

ISSUE DATE: August 5, 1999

DOCKET NO. E-002/M-96-1405

ORDER DEFERRING CONSIDERATION OF BIOMASS GENERATION PROPOSALS

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

Edward A. Garvey
Joel Jacobs
Marshall Johnson
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Gregory Scott

Chair
Commissioner
Commissioner
Commissioner
Commissioner

In the Matter of Northern States Power
Company's Petition for a Variance From
Competitive Bidding for Biomass Phase II
Resources

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BIOMASS GENERATION PROPOSALS

PROCEDURAL HISTORY

BACKGROUND

Northern States Power Company (NSP or the Company) is contracting for biomass generated energy in order to meet the "biomass mandate" (Minn. Stat. § 216B.2424). This mandate is part of broader legislation that allows NSP to store spent fuel at its Prairie Island facility if it meets this biomass mandate and certain other requirements.

Minn. Stat. § 216B.2424 (1996) requires the Company to construct and operate, or purchase by December 31, 1998:

- 50 MW of installed capacity generated by farm-grown, closed-loop biomass to be operational by December 31, 2001 (**Phase I**).
- An additional 75 MW of installed capacity, similarly generated, to be operational by December 31, 2002 (**Phase II**).

**PHASE I
(Docket No. E-002/M-95-54)**

On February 17, 1998, NSP filed a petition for approval of its Power Purchase Agreement (PPA) with Minnesota Valley Alfalfa Producers (MnVAP). See In the Matter of the Petition by Northern States Power Company for Approval of its Biomass Phase I Power Purchase Agreement with Minnesota Valley Alfalfa Producers, Docket No. E-002/M-95-54.

On August 14, 1998, the Commission issued its ORDER granting MEC's intervention, allowing late-filed comments, and establishing supplemental comment period to allow MEC ample time to review the proprietary information in the case, and to file supplementary comments.

On October 13, 1998, the Commission issued its ORDER PROVIDING FOR

SUPPLEMENTARY RECORD DEVELOPMENT. In this Order, the Commission encouraged parties to provide further record material as they deemed appropriate in response to the Commission's concerns as expressed in the Order.

On April 22, 1999, the Commission issued its ORDER APPROVING POWER PURCHASE AGREEMENT, SUBJECT TO CONDITIONS.

On June 11, 1999, the Commission issued an Order denying MEC's petition for reconsideration.

PHASE II
(Docket No. E-002/M-96-1405)

On November 12, 1996, NSP filed a request for a variance from the competitive bidding process for **PHASE II** of the biomass resource acquisition.

On March 12, 1997, the Commission issued its ORDER GRANTING WAIVER OF COMPETITIVE BIDDING REQUIREMENT. This Order allowed NSP a one-time variance from the bidding requirement and authorized the Company to conduct simultaneous negotiations to acquire its **PHASE II** biomass resources.

On October 16, 1998, NSP filed a request for variance from simultaneous negotiation requirements for biomass **PHASE II** resource acquisition.

On November 20, 1998, the Commission issued an ORDER APPROVING REQUEST FOR VARIANCE.

On January 11, 1999, NSP filed two separate requests: one for Commission approval of a power purchase agreement each for 25 MW of biomass-fueled generation with St. Paul Cogeneration, LLC (District Energy), the other for Commission approval of a power purchase agreement for 25 MW of biomass-fueled generation with EPS/Beck Power, LLC.

On January 22, 1999, NSP filed a corrected summary of its filing and amended Exhibit B.

On March 12, 1999, the Minnesota Department of Public Service (the Department) filed its comments, recommending that the Commission impose substantial modifications and approve the two PPAs so modified.

On March 29, 1999, reply comments were filed by NSP, the Department, the Residential Utilities Division of the Office of the Attorney General (RUD-OAG), the Izaak Walton League of America (IWLA), and Sustainable Energy for Economic Development Coalition (SEED) the Izaak Walton League of America (IWLA), and Sustainable Energy for Economic Development Coalition (SEED).

On April 16, 1999, Supplemental Comments were filed by EPS/Beck, NSP, the Department, the RUD-OAG, the Izaak Walton League of America (IWLA), and Sustainable Energy for Economic Development Coalition (SEED).

On April 19, 1999, ME3 filed Supplemental Comments.

On July 6, 1999, NSP, EPS/Beck, and District Energy filed a joint motion for a protective order pursuant to Minn. Stat. § 216A.05 and 471.705.

The Commission met on July 8, 1999 to consider this matter.

FINDINGS AND CONCLUSIONS

I. PROCEDURAL MATTERS

A. Protective Order

In their joint motion for a Protective Order, NSP, EPS/Beck, and District Energy argued that a Protective Order was necessary to protect certain trade secrets and other privileged material contained in the parties' PPAs. They stated that granting the Protective Order would allow the Commission the flexibility to engage in a frank and open discussion about the PPAs while at the same time protecting the parties' legitimate trade secrets. The parties' proposed Protective Order contained a provision allowing representatives of District Energy and EPS/Beck to remain in the hearing room during any closed portion of the meeting.

None of the other parties to this matter objected to the proposed Protective Order.

The Commission finds that the proposed Protective Order is appropriate. Each of the items identified to be protected by the Order is deemed a trade secret of NSP and the respective contract vendors. The proposed Order is narrowly and properly drawn to protect these items while allowing for helpful participation by EPS/Beck and District Energy in any portion of the hearing that is closed.

On August 5, 1999, the Commission issued the Protective Order, as requested and for the reasons stated.

B. Late-filed Documents

District Energy offered various late-filed documents which it characterized as letters of support and requested that the Commission allow them to be filed and considered part of the record of this matter. For its part, EPS/Beck requested that a copy of the typed version of remarks made orally at the July 8, 1999 hearing by Dave Ostlie, EPS/Beck's Vice-President be allowed into the record.

No party objected to including these documents in the record.

The Commission finds that granting these requests will prejudice no party and will, accordingly, grant these requests.

II. THE TWO PROPOSED PPAS

NSP has presented the Commission a scenario under which it would meet the balance of the biomass generation requirement Biomass Mandate via two PPAs, each of which would generate 25 MW using the required biomass fuel. One is a contract between NSP and EPS/Beck; the other is between NSP and District Energy.¹ The Company submitted both PPAs to the Commission for approval.

A. Background

The PPA which the Commission addresses in this Order was entered into as part of NSP's statutory mandate (Minn. Stat. § 216B.2424, the Biomass Mandate) to purchase electricity generated using "farm-grown, closed-loop" biomass as fuel. The Commission has conducted its review of the PPA pursuant to Minn. Stat. § 216B.1645 which requires the Commission to approve or disapprove PPAs entered into under the Biomass Mandate.

B. Evaluation of the Proposed PPAs

1. Summary

Having considered the comments and arguments of all the parties as well as all the documents filed in this matter, the Commission concludes that the record does not demonstrate that NSP's PPAs with EPS-Beck and District Energy are reasonable and in the public interest. Accordingly, the Commission will not approve these contracts at this time.

2. Framework of Analysis

In reviewing the twin 25MW biomass PPAs that NSP has proposed, the Commission is sensitive to the fact that NSP is under statutory deadlines regarding provision of biomass-fueled generation. However, the Commission also has an obligation to protect ratepayers against unfair prices and unfair risks and to resolve any doubts as to the reasonableness of rates in favor of the ratepayers. Minn. Stat § 216B.03.

¹ The Biomass Mandate requires NSP to have 50 MW operational by December 31, 2001 (Phase I) and requires the Company to have an additional 75MW operational by December 31, 2002 (Phase II). Assuming viability of NSP's PPA with MnVAP for 75MW in Phase I, the Company would exceed the number of MW required to be operational by December 31, 2001 (Phase I), leaving only 50 additional MW to be produced by December 31, 2002 (Phase II). Any change in the viability of MnVAP's 75MW PPA, of course, would affect the amount the Company would be required to arrange for in Phase II.

3. Cost and Rate Impact Considerations

With specific regard to the costs and rate impact of the proposed PPAs, the Commission finds that it cannot conclude, based on the record established in this case, including the statutory requirements of Minn. Stat. § 216B.2424, that the cost of power produced under the proposed PPAs is reasonable and that the PPAs will result in just and reasonable rates.

In evaluating the reasonableness of the rate impact of the proposed PPAs, the Commission notes that the Legislature determined in 1994 that NSP and its customers would be statutorily obligated to bear the higher cost of a certain amount of biomass generation in order for NSP customers to retain access to low cost nuclear generation from Prairie Island. The Commission acknowledges that these circumstances made the upward rate impact foreseeable and inevitable. However, this fact does not preclude the Commission from considering the likely size of the proposed rate impact and determining whether, given the circumstances of the case, the size of that impact is reasonable.

4. Indicators of Unreasonableness

In this case there are several indicators suggesting that the costs of meeting the Biomass Mandate in the manner proposed by NSP are not as low as they reasonably could be and that, therefore, the rate impact of the two PPAs proposed here is not reasonable.

At the outset, it is important to note that the fact that both projects were selected pursuant to a fair Commission-approved process does not mean that their costs (hence their rate impacts) are reasonable. In the biomass context of especially limited vendors, the process used in reaching the proposed contracts could not adequately substitute for competition.

As an initial observation, the energy prices from both proposed projects (the EPS/Beck 25MW project and the District Energy 25MW project) are not only higher than the price of energy produced by conventional power and wind turbines, but also unattractive when compared with the price of the MnVAP Phase I project.

This is particularly noteworthy for the District Energy project because despite the many cost saving features of this project (including reduced tipping fees, solving a waste wood problem, selling otherwise wasted heat and using an established technology), the project is still more expensive to NSP's ratepayers than even the MnVAP project which uses an experimental technology, does not cogenerate, and does not burn a waste product. The contract with District Energy has the potential to be the most expensive of all the biomass projects. Using NSP's figures a comparison of real levelized discounted price (RLDP), the District Energy project is approximately 19 percent more per kWh than the MnVAP project.

As to the EPS/Beck 25MW PPA, it contains several more attractive terms and conditions than the original MnVAP contract and the District Energy contract. These terms flow most of the possible cost reductions through to NSP's ratepayers. However, the high price of the project is still a major concern, particularly if the cost reduction features do not materialize.

In addition, biomass technologies are not market-proven and tested and there are no benchmark prices to compare them with. This does not show that they are necessarily too high, but likewise it does not provide a ready-made way to demonstrate their reasonableness.

In short, since the price agreed to for neither proposed project resulted from a competitive bidding process, the prices are appropriately subject to careful review. In this case, for the three reasons just stated, the companies' proposals do not survive that review.

Moreover, the RUD-OAG has demonstrated that if the EPS/Beck project were to compete with District Energy to serve the entire remaining 50MW of the mandate it could have the lowest cost of all the biomass projects. Although EPS/Beck did not submit a 50MW proposal and displayed some reluctance to propose such a bid which, if selected by the Commission, would eliminate District Energy, no party has provided any convincing argument or information to show why EPS/Beck should not be encouraged to provide a competing bid for the full remaining 50MW. For instance, no compelling reason was provided why District Energy's 25MW project should be viewed as indispensable.

5. Conclusion

The Commission is not prepared on the basis of this record to accept the twin 25MW projects scenario. The Commission is not convinced that this scenario is the best (the most logical and economical) that can be obtained. As the RUD-OAG's figures illustrate, a 50MW proposal from EPS/Beck may well prove to be the less expensive and, hence, preferable option for providing the remaining 50MW. Since there is time to pursue improvements that will benefit the ratepayers, it would be unreasonable to fail to make that effort. In addition, the prospect that the Commission may choose EPS/Beck to do the entire 50MW may encourage District Energy to come up with a better (lower priced) bid on its 25MW project.

III. COMMISSION ACTION

In these circumstances, the Commission will delay approval of both Purchase Power Agreements (the Purchase Power Agreement between NSP and EPS/Beck and the Purchase Power Agreement between NSP and District Energy) until EPS/Beck Power, LLC has had an opportunity to submit and the Commission has had an opportunity to analyze a proposal for a 50MW facility.

At the same time, the Commission will encourage District Energy to modify its 25MW proposal, with the knowledge that the Commission will be comparing the 50MW proposal from EPS/Beck against the current package: EPS/Beck's 25MW proposal and District Energy's 25 MW proposal.

Finally, the Commission sees benefit in being able to review NSP's progress in meeting the Biomass Mandate in a comprehensive manner and, hence, for example, to consider the options for potential ratepayer savings due to economies of scale. The Commission, therefore, encourages NSP and MnVAP to meet prior to the Commission's next meeting on this matter to determine whether their (NSP and MnVAP's) biomass contract will continue or not and, if so, what it looks like so the Commission can know how much of 75MW currently committed to MnVAP is now

uncommitted. For the same reason, MnVAP is encouraged to be present the next time the Commission takes up this matter.

ORDER

1. This matter is deferred to allow EPS/Beck to file a proposal for a 50MW project. The Company is encouraged to do so expeditiously.
2. District Energy is encouraged to improve upon its proposed 25MW project and file it for Commission consideration.
3. Before the Commission's next meeting on this matter, NSP shall meet with MnVAP to determine whether their (NSP and MnVAP's) biomass contract will continue and, if so, what it looks like so the Commission can know how much of 75MW currently committed to MnVAP is now uncommitted.
4. This Order shall become effective immediately.

BY ORDER OF THE COMMISSION

Burl W. Haar
Executive Secretary

(S E A L)

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